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Supreme Court, U.S.
FILED
DEC 17 2015
CLERK

No. 15-649

IN THE

Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,
Petitioners,

v.

JEVIC HOLDING CORP., *et al.*,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF *AMICI CURIAE* NATIONAL EMPLOYMENT LAW PROJECT AND NATIONAL CONSUMERS LEAGUE IN SUPPORT OF PETITIONERS

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December 17, 2015

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

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INTERESTS OF AMICI CURIAE[1]

The *amici curiae* filing this brief are non-profit public interest advocacy organizations united by their concern that the decision below will enable corporate debtors and creditors to evade the priority scheme enacted by Congress in the Bankruptcy Code, making it more difficult and expensive, if not impossible, for small creditors, such as employees with unpaid wages and customers with unrefunded deposits, to recover from corporate debtors in bankruptcy. *Amici* are particularly concerned that in the context of rapidly growing levels of wage theft – non-payment of accrued wages and benefits by employers – the Third Circuit's decision will further undermine employer accountability by creating a bankruptcy loophole.

The National Employment Law Project ("NELP") is a legal organization with over 45 years of experience advocating on behalf of low-wage and unemployed workers. NELP has a long-standing commitment to the enforcement of workplace rights and has litigated and participated as an *amicus* in numerous cases addressing workers' rights to wage and benefits payments. NELP has been particularly active in documenting and combatting the growing problem of wage theft.

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[1] Pursuant to this Court's Rule 37.2(a), all parties submitted letters to the Clerk granting blanket consent to *amicus curiae* briefs and counsel of record for all parties were timely notified of the intent of *amici* to file this brief. Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part, and that no person other than *amici* or their counsel contributed any money to fund its preparation or submission.

National Consumers League ("NCL") is the Nation's oldest consumer organization. Its mission is to protect and promote social and economic justice for consumers and workers. It advocates on their behalf and represents their perspective before Congress, administrative agencies and the courts.

SUMMARY OF ARGUMENT

This case involves the legality of a structured dismissal of a Chapter 11 bankruptcy case whereby the bankruptcy court (i) approves a settlement of a claim held by the estate, (ii) pursuant to the settlement, authorizes the distribution of the proceeds (which constitute all the assets of the estate) to creditors in a manner contrary to the priorities set forth in Section 507(a) of the Bankruptcy Code, and (iii) dismisses the case.

Nothing in the Bankruptcy Code authorizes such an order, this Court has never upheld a bankruptcy court order contrary to the Section 507 priorities, and the Fifth Circuit has held that such orders are *per se* unlawful. However, in the decision below, the Third Circuit upheld a structured dismissal order that authorized the distribution of the estate's remaining assets to general unsecured creditors, to the total exclusion of the debtor's employees, whose claims for unpaid wages and benefits were entitled to statutory priority under 11 U.S.C. § 507(a)(4) and (5).

The Court should grant the petition for certiorari because this case involves a clear circuit split on a recurring issue that goes to the heart of the Bankruptcy Code. The 2-1 majority panel decision of the Third Circuit below violates Congress's long-

standing scheme of bankruptcy priorities, which is essential to safeguard the interests of small creditors, such as employees and consumers, who are most in need of protection in corporate bankruptcy proceedings. As the U.S. Trustee explained in its Third Circuit *amicus* brief arguing against the position the Third Circuit ultimately took, the decision below

> sanctions a mechanism that permits parties to distribute estate assets (here proceeds from the compromise of estate causes of action) in violation of the priorities established by the Bankruptcy Code for the payment of creditor claims. That decision undermines a fundamental principle of bankruptcy that the debtor's assets will be distributed fairly and threatens to destroy confidence in the bankruptcy system. Moreover, there appears to be no reason why the . . . rationale could not be extended to permit parties to violate other Code requirements in the context of a settlement, so long as the bankruptcy court found that the settlement benefitted some of the creditors.

Brief of the United States as Amicus Curiae Supporting Reversal, *In re Jevic Holding Corp.*, 787 F.3d 173 (3d Cir. 2015).[2]

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[2]*Amici* commend the U.S. Trustee's Third Circuit *amicus* brief to the Court's attention. In view of the important "watchdog" role

ARGUMENT

I. THERE IS A CLEAR, RIPE AND IMPORTANT CIRCUIT SPLIT INVOLVING FREQUENTLY RECURRING ISSUES

There is a clear, ripe split among the circuit courts of appeal on whether bankruptcy courts can order the distribution of estate assets in a manner that disregards the Code's statutory priority scheme.

The Fifth Circuit has adopted what *amici* submit is the correct rule: it is a *per se* abuse of discretion for a bankruptcy court to approve a settlement that does not adhere to the priority scheme. *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984). In *AWECO*, the Fifth Circuit ruled that a bankruptcy court may approve a compromise or settlement only if it is "fair and equitable," with "fair and equitable" being "terms of art" meaning that senior interests are entitled to absolute priority over junior interests. *Id.* (citing *SEC v. American Trailer Rentals Co.*, 379 U.S. 594 (1965)).

The Second Circuit has rejected the Fifth Circuit's *per se* rule, opting instead for a balancing test

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played by the Office of the U.S. Trustee in ensuring the proper application of the bankruptcy laws, the Court might consider calling for the views of the Solicitor General. In addition, the Government has some degree of common interest with petitioners and *amici* in the question presented, since the bankruptcy priorities in Section 507 of the Code undermined by the decision below include not only priorities for employee and consumer claims, but also a priority for certain allowed unsecured claims of governmental units, *see* 11 U.S.C. § 507(a)(8).

to determine under what circumstances a bankruptcy estate's assets can be distributed in a non-priority manner. *See Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452, 464-65 (2d Cir. 2007). Under the Second Circuit's *Iridium* test, adherence to the Code's priority scheme is the "most important factor" in determining whether a settlement is "fair and equitable," but it can be overridden if "the remaining factors weigh heavily in favor of approving a settlement." *Id.* Parties seeking a settlement that deviates from the priority scheme must present "specific and credible grounds to justify that deviation." *Id.* at 466.

The Third Circuit decision below likewise rejects the Fifth Circuit's *per se* rule and adopts the *Iridium*-style balancing test. Pet. App. 19-20a. Therefore, a clear and acknowledged circuit split has arisen.

This is not a matter of a few, isolated cases, and it is not an appropriate case to leave the issue to percolate in the other courts of appeals. First, the courts of appeals involved – the Second, Third and Fifth Circuits – have an outsized importance for bankruptcy law. The three federal districts in which the most Chapter 11 bankruptcies are filed are in those circuits: the Southern District of New York, the District of Delaware, and the Northern District of Texas. *See* Jay M. Goffman et al., *Trends in Chapter 11 Filings, Venue and Proposed Reforms* (Jan. 2015), https://www.skadden.com/insights/trends-chapter-11-filings-venue-and-proposed-reforms. From November 2013 through March 2015, approximately 68 percent of Chapter 11 bankruptcies were filed in these three venues. *See* GAO, *Corporate Bankruptcy: Report to*

the Senate Judiciary Committee, app'x III at 42 (Sept. 2015), http://www.gao.gov/assets/680/672696.pdf.

Second, structured dismissals are a growing and controversial trend in bankruptcy law. *See* Pet. App. 13a; *see also* Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative after Asset Sales*, 29 AM. BANKR. INST. J. (June 2010), http://www.coleschotz.com/2B7963/assets/files/News/293.pdf ("[T]here is clearly a trend developing where courts are more frequently entering orders approving structured-dismissal orders."). Moreover, the Third Circuit's liberal approach to approving settlements in structured dismissals, creating an opportunity for the settling corporate parties to bypass priority creditors, is likely to encourage more, and more problematic, motions for approval of structured dismissals. *See* Jonathan C. Lipson & Steven Walsh, *Analysis of Third Circuit Approval of Structured Dismissals in Jevic Holding Corp.*, ABA BUSINESS BANKRUPTCY COMMITTEE NEWSLETTER, at 3, http://apps.americanbar.org/buslaw/committees/CL160000pub/newsletter/201507/fa_3.pdf (predicting that the Third Circuit's *Jevic* holding will "invite further litigation to test its boundaries").

Third, this is an area in which disputed cases that reach the appellate courts are just the tip of the iceberg.[3] The costs of bankruptcy litigation, and the

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[3] The issue of priority-skipping structured settlements was percolating for some time in the lower courts within the Third Circuit before the decision below. *See, e.g., In re Kainos Partners Holding Co.*, No. 10-560-LPS, 2012 WL 6028927 (D. Del. Nov. 30, 2012) (approving such a settlement); *In re World Health Alternatives, Inc.*, 344 B.R. 291 (Bankr. D. Del. 2006) (same).

risk that contentious proceedings will dissipate the estate's assets, impose strong pressure to settle on creditors, especially small creditors such as employees and consumers who cannot afford or justify large legal fees. Therefore, the principal effects of a rule permitting priority-skipping structured settlements appear not in appellate decisions but in creating leverage that frames settlements. Since the Third Circuit's decision, sophisticated corporate bankruptcy attorneys have already raised the specter of a potential priority-skipping structured dismissal in multiple cases to induce small priority creditors to settle on unfavorable terms. *See, e.g.*, Nick Brown, *Trucker's bankruptcy exit may roughen road for small creditors*, REUTERS (June 24, 2015), http://www.reuters.com/article/jevic-bankruptcy-idUSL1N0Z91BF20150624.

Finally, this case both illustrates and aggravates the pervasive problem of workplace injustices due to unequal bargaining power. Unlike many wage-earners, the nearly 1,800 truck driver employees of Jevic represented by petitioners have been able to sustain this lengthy and expensive litigation because they are well organized and have been well represented, including by *pro bono* counsel. However, they have still received no relief on their claim for accrued but unpaid wages and benefits more than seven years after they were laid off without notice in violation of state law. The structured dismissal order sanctioned by the Third Circuit has opened a bankruptcy loophole enabling their employer to escape without paying them. This represents an additional opportunity for wage theft – employers failing to pay employees what they have earned,

without effective accountability – at a time when, as U.S. Department of Labor and independent studies collected by NELP reflect, wage theft has reached epidemic proportions nationwide.[4] Unless this Court acts to close it, the bankruptcy loophole opened by the decision below is likely to result in many thousands of additional employees being denied what they have earned. Moreover, as with other forms of wage theft, the vast majority of those employees will not have the bargaining power to secure their rights or the resources to bring the problems to the courts' attention.

II. THE DECISION BELOW UNDERMINES FUNDAMENTAL BANKRUPTCY PRINCIPLES THAT ARE ESSENTIAL TO PROTECT SMALL CREDITORS

The Third Circuit's decision undermines fundamental bankruptcy principles and invites manipulation of the bankruptcy process to eviscerate the priority rights Congress expressly conferred on those most in need of protection in the bankruptcy process: employees and consumers with relatively small claims against the estate.

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[4] *See, e.g.*, NELP, *Winning Wage Justice: A Summary of Research on Wage and Hour Violations in the United States* (July 2013), http://www.nelp.org/content/uploads/2015/03/WinningWageJusticeSummaryofResearchonWageTheft.pdf; U.S. Dep't of Labor, *Workers Face Millions in Unpaid Wages in Southern California Garment Industry* (Nov. 6, 2014), http://www.dol.gov/opa/media/press/whd/WHD20142047.htm; U.S. Dep't of Labor, ***1999-2000 Report on Initiatives*** (Feb. 2001), http://nelp.3cdn.net/a5c00e8d7415a905dd_o4m6ikkkt.pdf.

Section 507 of the Bankruptcy Code lists in descending order of priority ten categories of priority claims, all of which have priority over claims of general unsecured creditors. This case directly involves categories 4 and 5 – employees of the debtor with unpaid wage and benefit claims. *See* 11 U.S.C. § 507(a)(4) & (a)(5). But, by sanctioning structured dismissals that distribute estate assets in violation of the Section 507 priorities, the Third Circuit's decision also undermines the congressional priorities for, among other categories, farmers and fishermen, *see* 11 U.S.C. § 507(a)(6), consumers and renters, *see* 11 U.S.C. § 507(a)(7), and certain governmental units, *see* 11 U.S.C. § 507(a)(8). In Section 507, Congress explicitly "specifie[d] the kinds of claims that are entitled to priority in distribution, and the order of the priority." H.R. Rep. No. 95-595, at 357-58 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963. And in Section 103 of the Bankruptcy Code, Congress instructed that Section 507 shall apply regardless of whether a case is proceeding under chapter 7, chapter 11, chapter 12, or chapter 13 of the Code. *See* 11 U.S.C. § 103(a).

Section 507's priority scheme is mandatory; it is not subject to a bankruptcy judge's discretion. *See, e.g., United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213, 229 (1996); *United States v. Noland*, 517 U.S. 535 (1996). Where Congress found cause for an exception, Congress specified it expressly. *See* 11 U.S.C. §§ 364(c), 510, 724(b), 726(a) & (b), 901. None of those exceptions are at issue in this case. *See also In re Roth American, Inc.*, 975 F.2d 949, 956 (3d Cir. 1992) (where "Congress intended to alter the priority scheme established in section 507, it has done so explicitly"). Where flexibility is needed, Congress

provided for it on a fully consensual basis: creditors entitled to priority under Section 507 may waive their rights to priority under a plan by accepting different treatments if, and only if, they choose to do so. *See* 11 U.S.C. §§ 1129(a)(8)(A), 1222(a)(2)(B), 1322(a)(2).

The Section 507 priorities reflect important and long-standing congressional judgments about what is fair and equitable in relation to the distribution of bankruptcy estate property. The priorities are an essential part of the social compact implicit in the Bankruptcy Code: Congress grants debtors protection against creditors, but on the condition that they distribute their assets equitably, in accordance with Congress's priorities. If, as the Third Circuit's decision portends, the priorities are undermined, sophisticated corporate debtors can be expected to manipulate the bankruptcy process to favor their business partners and unfairly disadvantage other creditors – especially those, such as employees and consumers, who have less familiarity with the bankruptcy process and fewer resources to enforce their rights. *Cf. In re Wabash Valley Power Ass'n*, 72 F.3d 1305, 1314 (7th Cir. 1995) ("[T]he absolute priority rule was a judicial invention designed to preclude the practice in railroad reorganizations of 'squeezing out' intermediate unsecured creditors through collusion between secured creditors and stockholders (who were often the same people).").

The wage priority in Section 507(a)(4), in particular, has a long history and compelling rationales. The concept that wage earners should receive priority status among creditors has its origin in the Bankruptcy Act of 1841, in which Congress created three categories of priority, one of which was

wages due to "operatives" (*i.e.*, employees). *See* C. Scott Pryor, *The Missing Piece of the Puzzle: Perspectives on the Wage Priority in Bankruptcy*, 16 AM. BANKR. INST. L. REV. 121, 125-26 (2008). Since that time, the wage priority has been a mainstay in all subsequent iterations of U.S. bankruptcy law, through the creation of the modern Bankruptcy Code. *See id.* at 128-41.

It has long been recognized that the wage priority, along with the priorities for employee benefits, farmers, fishermen and consumers in Section 507(a)(5)-(7), acts as an important bulwark against the inherently unequal bargaining power that is a feature of most bankruptcy proceedings. *See, e.g.*, Paul G. Kauper, *Insolvency Statutes Preferring Wages Due Employees*, 30 MICH. L. REV. 504, 507-08 (1931) (discussing factors that impair employees' bargaining power in bankruptcy context, including inability to ascertain employer's credit, limited financial resources, dependency on income from employer, and lack of security interest). While large debtor and creditor corporations often have substantial sums at stake, large legal budgets, the financial ability to sustain long and complex litigation, and, in many cases, the opportunity to anticipate and negotiate around bankruptcy developments, workers and consumers typically have smaller claims, smaller budgets, and less ability to sustain complex litigation, and they are often the last to know of relevant developments. As this Court explained over a century ago, wage earners merit priority status because they "necessarily depend[] upon their daily labor" for subsistence. *Guarantee Title & Trust Co. v. Title Guar. & Sur. Co.*, 224 U.S. 152, 160 (1912); *see also*

Blessing v. Blanchard, 223 F. 35, 37 (9th Cir. 1915) ("Priority of payment was intended for the benefit only of those who are dependent upon their wages ... [and therefore] would be in need of such protection."); *In re Nw. Eng'g Co.*, 863 F.2d 1313, 1318 (7th Cir. 1988) ("Workers do not have diversified portfolios of employment. One business failure is all they care about."). The present case is typical: petitioner employees were given one day's notice of their employer's bankruptcy filing, and have now endured years of litigation seeking to recover their unpaid wages and benefits.

The wage priority also serves an important function for debtors, to the benefit of all involved. Assuring employees of priority status for their wages increases the probability that they will stay to participate in a reorganization effort. *See* Daniel Keating, *The Fruits of Labor: Worker Priorities in Bankruptcy*, 35 ARIZ. L. REV. 905, 907 (1993) ("[I]n a case where the employer is attempting to reorganize in bankruptcy, the employees will almost always be crucial to the success of such an undertaking."); *Nw. Eng'g Co.*, 863 F.2d at 1315 ("If employees were treated in all respects as unsecured creditors, they would be inclined to desert a leaky ship, speeding up the firm's collapse.").

Moreover, most creditors in bankruptcy proceedings knowingly extended credit to the debtor, fully cognizant of the potential risks. On the other hand, employees are not traditionally seen as "extending credit by waiting for their paychecks," and thus are less likely to have fully vetted the possible risks associated with a debtor. 4 *Collier on*

Bankruptcy ¶ 507.06 (16th ed. 2015). The same rationale applies equally to the consumer priority.

Despite Congress's clear instructions as to the Section 507 priorities and their compelling rationales, the panel majority in the decision below adopted a rule that allows non-priority creditors to combine with the debtor to formulate a structured dismissal that distributes estate assets in a manner that entirely and purposefully excludes priority creditors. That ruling violates, and fundamentally undermines, Section 507.

III. THE DECISION BELOW IS NEITHER JUSTIFIED NOR NARROW IN ITS IMPLICATIONS

The panel majority below justified the application of a purportedly narrow exception to Section 507 in the structured dismissal context on the basis that it was the "least bad alternative" because, according to the bankruptcy court, "there was 'no realistic prospect' of a meaningful distribution to Jevic's unsecured creditors apart from the settlement under review," Pet. App. 21a, which was conditioned on the priority creditor employees receiving nothing for their claims. But there is a fundamental flaw in this reasoning, and the Third Circuit's exception is both unnecessary and unlikely to prove as narrow as it suggests.

The essential jurisdictional premise of the Third Circuit's ruling is that it is up to the bankruptcy court to determine whether a priority-skipping structured dismissal is the "least bad alternative." *See* Pet. App. 21a (deferring to the bankruptcy judge's view that the arrangement proposed by the corporate

creditors and debtor and opposed by petitioner employees was the "least bad alternative"). But that mistakes the bankruptcy court's role. When an otherwise lawful settlement involving an estate in bankruptcy is proposed, it is subject to bankruptcy court approval to ensure that the trustee in bankruptcy is meeting its fiduciary duties and the settlement is "fair and equitable." *See* Fed. R. Bankr. P. 9019; *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*, 390 U.S. 414, 424 (1968). The Third Circuit purported to apply that standard, *see* Pet. App. 11a, and, by a 2-1 majority, found it to be met, *see id.* at 21a-23a.

However, nothing in the Bankruptcy Code or the Bankruptcy Rules authorizes a bankruptcy court to sanctify otherwise unlawful settlements or coercive arrangements that go beyond the scope of a settlement. A priority-skipping structured dismissal is not a lawful, consensual settlement: it deprives unconsenting priority creditors of their substantive rights to priority. To be a true settlement, and to be lawful notwithstanding Section 507, such an outcome must be agreed to by the party losing the right to priority. *See* 11 U.S.C. § 1129(a)(8)(A).

The Third Circuit majority deemed this conclusion "nihilistic and distrustful of bankruptcy judges." Pet. App. 23a. But it is not. The substantive premise of the decision below is that it was proper for the bankruptcy court to "choose," Pet. App. 22a, to adopt the corporate respondents' structured dismissal proposal over the employee petitioners' objections because it was a Pareto superior choice: other creditors would be better off, and the employees would be no worse off, as a result. *See* Pet. App. 21a-22a.

But if that were the case, abiding by the Section 507 priorities would not amount to "nihilis[m]." As already noted, it is undisputed that those priorities can be waived by consent, and that consent can be secured by negotiation. If the corporate parties had something to gain from sidestepping the Section 507 priorities, and (as the bankruptcy court opined) the employees had nothing to lose, they could, absent judicial interference, realize, and, as appropriate, share those gains by fully consensual negotiation. Like any property rule, Section 507 priority rules are neither inefficient nor "nihilist[ic]" so long as they can be used as a clear, mutually understood starting point for negotiations. "[S]ettlements are favored in bankruptcy," Pet. App. 19a, but voluntary negotiations informed by clear and waivable property rules, rather than judicial imposition of outcomes over objection, are the proper and efficient means to that end.

The present case aptly illustrates the shortcomings of the Third Circuit's approach. Whereas parties in actual negotiations can reach efficient solutions by calling each other's bluff, bankruptcy litigation is poorly suited to determining the "least bad" solution to a negotiating problem. Faced with the kind of roving commission issued by the Third Circuit to identify the "least bad alternative," a bankruptcy judge must either rubber-stamp the corporate parties' structured dismissal proposal or weigh it against "counterfactual" potential settlements including the priority creditors – a difficult balancing exercise the Third Circuit majority disdained, *see* Pet. App. 21a.

In making that judgment, the bankruptcy court will be hard-pressed to overcome the effects of the corporate parties' framing of the dilemma: contentions, such as those successfully made in this case, that the corporate parties would never have agreed to settle on terms favorable to the priority creditors will be difficult to scrutinize effectively, so professions of intransigence are likely to be rewarded. See Pet. App. 24a-25a (Scirica, J., dissenting) (explaining that the failure to reach a settlement with petitioner employees on which respondents relied to justify excluding the employees from any recovery "was, at least in part, a product of [respondents'] own making"). Corporate parties will rationally proffer a different "last and final" offer based on whether they believe the priority rule will be enforced or not. As here, when those parties wager it will not be enforced in a structured dismissal, courts will never see or be able to "choose" what the most fair and equitable arrangement might have been. Moreover, the judge is likely to consider the parties' relative bargaining power – and thus, to make the relatively weaker bargaining power of employees and other small claimants a self-fulfilling prophesy.

The process of judicially identifying a "least bad" solution through contested bankruptcy litigation will inevitably be lengthy, expensive and burdensome, unless and until the party with fewer resources – the small creditor – is compelled by the burden of litigation to surrender. And if it is fought through to the end, the result may be uncertain. Revealingly, in the present case, Judge Scirica dissented from the majority's conclusion that the settlement was the "least bad alternative," *see* Pet. App. 24a-25a, and the

majority defended it based in part on deference to the bankruptcy judge, *see* Pet. App. 21a.

The Third Circuit suggested that under its rule, priority-skipping structured dismissals would "be justified only rarely." Pet. App. 23a. In doing so, it assumed that they will rarely be the "least bad alternative." But the reality is that, by creating a supposedly narrow exception to Congress's priority scheme, the Third Circuit has let the genie out of the bottle. Given an exception, corporate counsel would have ample opportunity and incentive to frame extreme negotiating positions that would preclude consensual alternatives, and to wear down employees and other small creditors through the bankruptcy litigation process. And that threat would tend to force those employees and customers who can recover any of the wages and deposits they are owed to settle on unfavorable terms, below the judicial radar. Not for the first time in bankruptcy proceedings, *see* Pet. at 28-29, the theoretically rare exception would then become the norm, enabling corporate litigators to manipulate the bankruptcy system to disadvantage small creditors.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

December 17, 2015

Respectfully submitted,

/s/ *Simon A. Steel*

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DECEMBER 17, 2015